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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943.

No. 631

BENJAMIN E. COHEN, ET AL.,

Petitioners,

vs.

LEONARD A. YOUNG, ALICE D. COFFIN, CHARLES M. YOUNG, L. A. YOUNG SPRING & WIRE CORPORATION, AMERICAN STEEL & WIRE COMPANY OF NEW JERSEY, ISAAC C. FORCHEIMER, LUCILLE K. LEVY, MARIANNE L. FISHER, ROSALIE B. SPERRY, AND JOSEPHINE YANKAUER,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF IN SUPPORT OF PETITION.

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JURISDICTION INVOKED.

The jurisdiction to grant the Writ of Certiorari is invoked under §240(a) of the Judicial Code as amended by the Act of November 13, 1935 (43 Stat. 1938, 28 U. S. C. A. Sec. 47). The judgment of the United States Court of Appeals was rendered April 21, 1943 (Tr. 428). It became final by the denial of the rehearing on December 1, 1943 (Tr. 437) and the petition is filed within the time allowed by the Act.

OPINIONS BELOW.

The opinion reversing the first settlement decree of June 29, 1940, and remanding the case for further proceedings not inconsistent with the views expressed in the opinion was published. (*Cohen* v. *Young, et al.*, 127 F. (2) 721.)

The opinion stated (127 F. (2) 721) at page 726:

> "The conceded facts show abuse of the corporate powers by officers and directors, extensive borrowing of corporate funds and conversion of thousands of shares of stock by its president."

It further stated:

> "The appellants had a right to invoke the discretion of the court to decide whether the compromise recommended did in fact protect the interests of the corporation and of the stockholders."

The *per curiam* opinion affirming the second settlement decree of August 13, 1942, appears in this record (Tr. 428) and the opinion was also published (*Cohen* v. *Young, et al.*, 135 F. (2) 625).

The opinion held that the jurisdiction of the judge was limited to the issue of insolvency and that petitioners had no right to invoke the discretion of the court on the question whether the compromise was in fact protecting their rights.

ERRORS RELIED ON FOR REVERSAL.

1. The Court of Appeals clearly erred in affirming the settlement decree based on the limitation of the issues to the insolvency of Young and the denial of the motion for leave to intervene and to file the proposed complaint seeking additional and supplemental relief.

2. It was the duty of the Court of Appeals to reverse the decree which was based on clearly erroneous findings which were not sustained by any competent evidence, and not on the findings proposed by the petitioner which were supported by the undenied proof.

3. The Court of Appeals erroneously concluded that the decree of the court was based on findings which were supported by substantial evidence, and it was its duty to hold that the evidence was incompetent, particularly in the following respects:

(a) In receiving the evidence of the witness White as to the valuation of the 112,885 shares at $6.00 per share based on a market quotation of an isolated day without any showing of actual sales and a normal market, and without considering any of the essential elements concerning such valuation.

(b) In basing its findings on the incompetent evidence of the witness White relating to the value of real and personal property based on assessments for taxing purposes, and with no knowledge as to the real value thereof.

(c) In finding the insolvency of Young on the incompetent testimony of the witness White which was based on the assumption that the transfer of Young to his wife of the major part of his assets and the creation of the liability in her favor of over $3,500,000.00 was a valid transfer and a valid obligation.

(d) In basing the findings as to the valuation of the personal and real property of Young on tax assessments, and without competent evidence as to the real value.

(e) In sustaining objections of the defendants to the competent evidence offered by the petitioners and in refusing to receive competent evidence on their behalf.

4. The approval by the Court of Appeals of the decree which was based on the finding that Young was insolvent because his 112,885 shares were quoted on May 31, 1942, at $6.00 per share when the evidence showed that it was worth $22.00 per share, was clearly erroneous.

5. The Court of Appeals clearly erred in sustaining the conclusion of the insolvency of Young based on the validity of the transfer of his major assets to his wife and the establishing of his liability to her in excess of $3,500,000.00 at a time when he claimed he was unable to meet the payment of the debt of $720,000.00 to the corporation of which he was the dominant stockholder and officer.

6. The Court of Appeals clearly erred when it sustained the action below in rejecting the findings requested by the petitioners that there were assets in excess of $1,000,000.00 on which the corporation was entitled to impress a trust to the exclusion of all other creditors, and by reason thereof the settlement was unfair even if Young was actually insolvent.

7. The Court of Appeals erred in sustaining the denial of the motion for leave to intervene and to file the proposed complaint to which the petitioners were entitled as of right and not as a favor under Rule 24, and even if the matter was discretionary, it clearly abused its discretion, and it was its duty to so hold.

8. The Court of Appeals completely overlooked its own restraining order which it issued upon its consideration of the record and it lost sight of the valuable assets which it preserved by the restraining order and which would be lost to the corporation upon the approval of the settlement decree.

9. It was the duty of the Court of Appeals to first pass on the competency of the evidence before it concluded that the findings were supported by substantial evidence, particularly when this was called to its attention in the petition for rehearing, and it clearly erred in not granting the rehearing.

10. The proposed findings as presented by petitioners were supported by undenied proof, and the conclusions of law drawn therefrom were sustained by the authorities, and it was the duty of the Court of Appeals to reverse the decree which was based on findings that are not supported by any competent evidence and to direct the entry of a decree on the findings proposed by the petitioners, which are supported by the undenied proof.

11. The reasons which prompted the District Court to issue its temporary restraining order existed when it entered the final decree approving the settlement, as the danger was not removed by the settlement, and it was its duty to make the restraining order permanent and to grant other protective measures as prayed for by the alleged class representatives, and by these petitioners, and the Court erred in not granting such relief.

12. It was the duty of the Court of Appeals to consider the effect of its own restraining order and the reasons which prompted it to issue such order upon a study of the record, after the denial thereof by the District Court, and it failed to consider that independently of the solvency or insolvency of Young, the free assets which could have been subjected to the prior claim of the corporation exceeded in value double the amount what he offered in settlement, and it erred in not reversing the decree with directions to permit the filing of petitioners' complaint and to grant the relief prayed therein.

ARGUMENT.

STATEMENT OF THE CASE.

The facts are summarized in the opinion of the Circuit Court of Appeals on the former appeal when it reversed the decree below (*Cohen* v. *Young,* 127 F. (2) 721). In addition thereto it is necessary to set forth the additional facts which occurred since the remandment order upon the redocketing of the case.

Preliminary to taking evidence the court made some observations of a "sort" of "bringing the proceedings up to date" (Tr. 107). The observations of the court are very important in understanding its attitude and its ruling on the evidence. The court stated that it "assumed" that there were "seven annual meetings", and that "at each one of these annual meetings" the original plaintiff "had an opportunity to be heard"; that "he advised his fellow stockholders of all the charges" set forth in his complaint, and "all of the stockholders have had notice of the claims of mismanagement", and "at each of the annual meetings they proceeded to re-elect substantially the same officers", and "the same management".*

After making these assumptions the court turned to Mr. Wagner, counsel for the plaintiff, saying (Tr. 105): "I am not sure that I am correct, quite correct, in that last statement, but I guess that's right—isn't it, Mr.

* The impropriety of these assumptions and the entire misconception of the court is best illustrated by the recent decision in *Toebelman* v. *Mo.-Kansas Pipe Line Co.,* 130 F. (2d) 1016, 1022.

Wagner?" To which the latter responded: "I think it is, that's right".*

In this preliminary statement the court also pointed out (R. 110)** that "stockholders representing a substantial number of shares have filed a petition to intervene and a proposed amended complaint" which (Tr. 111) "presents a somewhat different theory upon which recovery may be had", but it was not unmindful of the fact that the opinion of the court limited the retrial to the single issue of Young's insolvency. However, *it was not certain "that that limitation would have been placed in the opinion" if "the petition for intervention in its present form, together with the proposed amended complaint were presented to that court"*, and, therefore, there was the question whether the mandate of the court was a limit on its jurisdiction as to prevent the intervention and the filing of the amended complaint.

After hearing argument (Tr. 111-127), the court stated that it would limit the hearing to the question of insolvency, and if it would conclude that Young was solvent, the appellants would then be in a better position to urge their intervention (Tr. 127).

At the next hearing the question came up on whom the burden of proof was cast to prove the insolvency (Tr. 136). Plaintiff's counsel, Mr. Wagner, stated that he was convinced that Young was insolvent, and, there-

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* Mr. Wagner evidently forgot his own affidavit of June 7, 1939 (R. pp. 111-114), and the allegations made in his supplemental complaint of August 29, 1939 (R. pp. 117-127), and the verified complaint of the intervenors, Lucille K. Levy, *et al.* (R. p. 271), wherein it was charged that the frauds and mismanagement were concealed from the stockholders, and were unknown to the stockholders.

** "R" refers to Exhibit 3, the printed record on the former appeal and "Tr." refers to the printed record on this appeal.

fore, recommended the approval of the settlement, taking into account that Young was about 70 years of age (Tr. 137).* The statement of counsel for the other parties was to the same effect (Tr. 138). Petitioners' counsel stated that they considered Young to be solvent and opposed the settlement (Tr. 140-150). The court stated (Tr. 151) that the burden of proof was upon plaintiff's counsel to establish that their judgment was "sound", and (Tr. 152) "the parties who are here and in order to show cause will have a right to meet that proof, and go as far as they desire to establish that the compromise should not be accepted." **

Testimony of White: The first and principal witness for the plaintiff was Hugh White, the accountant who prepared the 1940 audit which was the foundation for Young's alleged insolvency under the reversed decree, and who also prepared the 1942 audit which is the foundation for the finding of insolvency in the new decree.

He testified on his direct that his 1940 audit showed that as of December 31, 1939, Young was insolvent by $3,811,590.39 (Tr. 159). Referring to the $1,621,906.58 in property which Young transferred to his wife in 1931 (Tr. 160), he said that even if such assets were included among his present holdings, he would still be insolvent to the extent of $2,190,000.00 (Tr. 161).

On cross-examination he was asked (Tr. 200) whether he included the $1,621,906.58 among Young's present assets. He first pretended not to understand the question, and later said that it was necessary for him to get his "thoughts together". After taking a recess to enable him

* The evidence showed he was 65 years old (Tr. 292).

** During the course of the hearing the court refused to receive such evidence (Tr. 272-281), and placed the burden on the petitioners to prove the invalidity of the deal between Young and his wife in arriving at its conclusions (Tr. 89).

to get his "thoughts together", he could not give any better answer (Tr. 202). He was then asked whether Young would be insolvent if the $1,621,906.58 was included among his assets and the liability to his wife in excess of $2,500,000 was excluded from the liabilities (Tr. 203) and he answered that he did not know. He later explained his answer (Tr. 206) that he could not answer the questions because he had no idea "what the value of the assets are". Finally he admitted (Tr. 206) that he considered the transfer of the $1,621,906.58 in property to be valid, and did not include this property among Young's assets (Tr. 207), and that he also assumed that the debt in excess of $2,500,000 from Mr. Young to his wife was a valid debt, but that he had no personal knowledge as to its validity (Tr. 207).

He also testified, on his direct examination, that he included in the present audit the account receivable, of $228,472.83 at its face value (Tr. 164). This is the same account which he scheduled in his 1940 audit with other accounts receivable at "$5,000" (Tr. 280).

He further testified on his direct that the 112,885 shares which Young owned in the corporation had a value of $677,130 based on the market quotation on May 31, 1942 at $6 per share (Tr. 165). He included in Exhibit 10 (Tr. 406) among the assets, real estate having a book value of $149,583.55 at an assessed tax valuation of $48,540. Besides this real estate which was in Young's name, he also included real estate having a value of $237,160, which stood in the joint names of Mr. and Mrs. Young because they were carried "on his books" (Tr. 167). In Exhibit 11, which this witness prepared after such testimony was given, and on which the court based its findings (Tr. 415), he excluded such real estate. He

also testified that other real estate which was transferred by Mr. Young to his wife was still carried on Young's books as his (Tr. 169).

The attention of witness (upon whom the respondents relied in making their previous recommendation to accept the settlement) was directed to his 1940 audit, which he made "without audit and verification" and he was asked (Tr. 174) whether it was "usual" to make such audits without "audit" and without "verification". He answered that it "depends on the examination", and that it is "often done", and that "he did it". When asked to give a single instance where he made such an audit he said, "I can't think of one right now." Finally he said (Tr. 175) that he was *instructed* to make the audit without "audit" and without "verification" by counsel (Tr. 175). His attention was then called to the fact that he was employed to audit an account on the question of the insolvency of Leonard A. Young in a court proceeding and whether it was usual for an auditor to make the audit as he did for the court without checking anything. He answered that *he relied on Young's sworn statement,* although he knew he was then charged with fraud, and he "never checked" Young's statement with the books to see if it was correct (Tr. 177). When asked (Tr. 178) whether it was not his duty to check the sworn statement with the books, he answered that he was very busy (Tr. 180).

On the question of the valuations in his audits he said that *he knew nothing about values* (Tr. 180), and simply took the assessed tax valuations for the values relating to the real estate (Tr. 181), and other property. He computed the stock on market quotations.

His attention was called to an asset of $30,953.28 which was due from T. D. Stewart, the Secretary and Treasurer of the corporation, which account he considered "worthless" in his 1940 audit as well as in the 1942 audit (Tr. 213). He said that he considered it worthless because he could not obtain a verification of the account (Tr. 214). He knew that he was employed by the corporation and he made no effort to check the account (Tr. 214). Mr. Stewart drew from the corporation a salary of $12,000.00 per year (Tr. 208).

Earnings of Young: Leonard A. Young was not 70 years old as plaintiff's counsel assumed (Tr. 137) but was 65 years of age (Tr. 91). He is president of the corporation and is president and director of several other corporations (Tr. 267). On May 2, 1932, he obtained a contract from the corporation for a 5-year term whereby he was to receive a salary of $50,000 a year, plus 10% of the consolidated net earnings of the corporation and its subsidiaries above $1,000,000 (Tr. 72). On January 7, 1938 (during the pendency of this cause) he obtained a similar contract for an additional 5-year term which was signed by his nephew, C. M. Young (Tr. 75).* This new contract was not disclosed

* Mr. Wagner, plaintiff's counsel, charged in the verified complaint that C. M. Young was elected president in order to execute another contract for the personal advantage of L. A. Young (R. p. 61). L. A. Young admitted that such a contract was executed, and that he received $150,000 thereunder (R. pp. 98-99), but claimed in his answer that the contract was cancelled and everything was in *status quo* (R. p. 100). However, a new secret agreement was executed simultaneously with the cancellation of the other contract, and the $150,000 was not returned (R. pp. 117-118). The total bonuses that he drew from 1935 to 1942, during the pendency of the suit, was $713,539.66 (Tr. 46) exclusive of the $50,000 annual salary and $24,000 annual expenses.

to the court when it entered the restraining order in 1939, restraining the payment in excess of $50,000 in salaries. He drew $148,404 in the year 1941 as a salary besides $24,000 in expenses (Tr. 299-300).* He also drew in dividends from the corporation $65,000 during the same year (Tr. 236). He further drew during that year from the Bohn Products Corporation $88,833.33 in 1940, and $30,000.00 in 1942 (Tr. 301). He drew in 1941 from the Lay Improvement Corporation $42,905.36 (Tr. 300). His total drawings for the year 1940 was $245,261.03, and for the year 1941 it was $302,493.56 (Tr. 417). He met each and every obligation as it matured from time to time, and reduced a debt from $274,000 to $75,000 in the last sixteen months (Tr. 291). No creditor ever had any trouble in collecting anything from him, and there are no outstanding judgments against him (Tr. 295). He loaned to his associate (T. D. Stewart) a sum in excess of $30,000 (Tr. 380) and never made an attempt to collect it from him (Tr. 269) while Stewart continued to draw his salary from the corporation (Tr. 269).

Assets as Found by the Court: His assets, according to the Court's findings were $1,756,375.84 (Tr. 89). These findings were based on the 1942 audit, which consists of the following (Tr. 415):

Cash on hand	$ 50,233.44
Cash on deposit	34,159.11
Notes and accounts receivable	334,425.00
Securities owned	1,233,330.00
Cash surrender value of life insurance	48,108.29
Real property owned	41,120.00
Personal property	10,000.00
Memberships	5,000.00
	$1,756,375.84

* See footnote in *Toebelman* v. *Missouri-Kansas Pipeline Co.*, 130 F. (2) 1016, 1021, "on the question of the effect of salaries so large as to amount to spoliation."

Assets Excluded: The marginal notation in the audit shows (Tr. 415) that White, as auditor, excluded certain properties which he included in Exhibit 10 of the 1942 audit which were there valued at $237,000 (Tr. 406). He excluded real estate held jointly by Young and his wife in the amount of $111,000; property which Young transferred to his wife in 1931 in the amount of $219,101.88.

According to Petitioners' theory such property should be added to the item "Real property owned", and the amount will, therefore, be changed from $41,120.00 to $589,048.76.

Assets Undervalued: In arriving at the value of the "securities owned" of $1,233,330.00 the auditor valued the 112,885 shares at $677,310, based on the market quotation of $6.00 per share on May 31, 1942 (Tr. 48).

According to petitioners' theory the stock should be valued at $22.00 per share (Tr. 40), and the securities owned would, therefore, be increased by $1,806,160. The item "securities owned" would, therefore, be changed from $1,233,330 to $3,039,490.

The "Notes and Accounts Receivable" were figured at $334,425. The auditor figured the account of $243,-897.83 at $108,000 (Tr. 407, 415). He eliminated the claim of $30,953.28 against Stewart.

According to petitioners' theory these two items should be included at their face value. The notes and accounts receivable would therefore be changed from $334,425 to $501,276.11.

Assets According to Petitioners' Evidence: The assets of Leonard A. Young, according to petitioners' theory, as shown by the evidence, are as follows:

Cash on hand	$ 50,233.44
Cash on deposit	34,159.11
Notes and accounts receivable	501,276.11
Securities owned	3,039,490.00
Cash surrender value of life insurance	48,108.29
Real property owned	371,221.88
Perosnal property	10,000.00
Memberships	5,000.00
	$4,059,483.83

The Liabilities: The liabilities of Young according to the findings of the court (Tr. 89) amount to $5,808,453.57. This is based on Exhibit 11 of the 1942 audit (Tr. 415). The marginal notation of the auditor states (Tr. 415) that he included the liability to Ola Young, the wife of Leonard A. Young, in the amount of $2,554,429.33. He also included the $275,000 which Young borrowed from the United States Steel Corporation to pay under the settlement decree, and which was used to pay under the present decree.

According to petitioners' contention and evidence the $2,554,429.33 and $275,000 should have been excluded from his liabilities and the alleged liability of $5,808,453.57 is actually only $2,979,024.24.

Solvency of Young: According to petitioners' evidence the financial status of Leonard A. Young is as follows:

Assets, $4,059,483.83; liabilities, $2,979,024.24; his net worth is $1,080,459.59. This net worth is based on the

valuations of the witnesses for the respondents pertaining to the real estate, and to the other property which was transferred under the 1931 agreement. According to petitioners' theory, the values are much larger, and the net worth is greater, and his potential earning capacity of about $300,000 per year should also not have been overlooked.

Property Impressed with a Trust: Regardless of the question of Young's solvency, the evidence shows that the corporation held collateral for an indebtedness of Leonard A. Young and his associates in the amount of $994,000. The collateral consisting of 40,983 shares and other securities then valued at $400,000 (R. p. 29) was removed by him when he obtained the cancellation of his collateral notes in exchange for Detroit Moulding Corporation stock (R. p. 41), then valued at less than $50,000. He still retains 8,804 unpledged shares (Tr. 90). The remainder of the shares he gave to his wife, and she still owns 14,157 shares (Tr. 90), which are unpledged. There are 87 shares in the possession of the Lay Improvement Corporation. The total unpledged shares are 23,048. If these shares be valued at $6 per share, as found by the court, the value thereof is $138,288. If they be valued at $22 per share, as contended by petitioners, the value thereof is $507,056.

The corporation was also possessed of the stock of the Bowen Products Corporation, as collateral for a loan to Leonard A. Young in the amount of $308,173, now valued at $555,750 (Tr. 408). The collateral was removed by Leonard A. Young when he owed a conceded balance of $198,000 (Tr. 277, 278, 284).

The United States Steel Corporation held as collateral certain real estate as security (R. p. 414). When Young obtained the $750,000 from the corporation to pay his personal debt to the United States Steel Corporation (R. p. 336) the latter released to him and to his wife the real estate which it held as security (R. p. 360). The value of this real estate amounts to $547,928.76 (Tr. 415, notes 2, 3 and 4).

Petitioners contend that the corporation was entitled to impress a trust on all of the assets and asked for such relief, which the court denied when it approved the settlement.*

The 1940 Audit: The previous settlement was based on the audit of White, Bower & Prevo, accountants. The audit (Tr. 377) was made "without audit or verification" (Tr. 379). It was purported to be made upon the books of Leonard A. Young (Tr. 174). The evidence at this trial showed that the 1940 audit contained an entry of $4,091.21 of cash (R. 379), which entry the auditor was unable to show in any of the books which he claimed to have examined when he made the audit (Tr. 233). This entry did not appear on any of the books on which his report was purported to be based (Tr. 344-345, 366).

The 1940 audit lumped "accounts receivable", aggregating $540,575.21 in an estimated value of $5,000 (Tr. 380). This included a debt from T. D. Stewart of $30,953.28 (R. 217), who was Secretary and Treasurer, Director and Stockholder of the corporation, receiving an

* Petitioners obtained a restraining order from the Court of Appeals to preserve the "*status quo*" during the pendency of the appeal (Tr. 428).

annual salary of $12,000 (Tr. 268). Leonard A. Young, who asserted that he was insolvent, never attempted to collect this debt (R. 269). The auditor who made the audit and who appeared as a witness at the trial in an effort to show that Young was insolvent, stated that he could not confirm this account, and therefore, eliminated it from Young's assets (Tr. 214). He admitted that he made no effort to locate Mr. Stewart, although he knew that he was employed by the corporation. A debt from L. A. Young Company to Leonard A. Young of $239,841.21 was also included among the alleged assets of $5,000.* The evidence at this trial shows that the debt was fully collectible as it appears from Exhibit 9 (Tr. 398), showing the debt as of May 31, 1942, of $243,767.19 and sufficient assets to pay the debt in full. The same accountant, who included this asset in the alleged "accounts receivable" of $5,000, figured the debt on its face value of $228,472.83 when he made up his Exhibit 10 as the basis for his testimony (Tr 407), and later changed it in Exhibit 11 to $108,000 (Tr. 415).

The Recommendations to Accept the Compromise: Based on the original audit which was made "without audit" and "without verification" counsel for the plaintiff and counsel for the other intervenors, the respondents herein, recommended to the court the acceptance of the compromise on the ground that Young was insolvent (R. p. 582), and the court entered its decree, relying on such recommendations (Tr. 110). They again urged the acceptance of the

* The auditor who estimated the accounts receivable of over $500,000 at $5,000 (Tr. 380) including the account of $239,841.21 now conceded that he was told by Mr. Young that the account was collectible (Tr. 172).

settlement at this trial based on the 1942 audit, which was made by the same auditor (Tr. 151) whose Exhibit 10, when he prepared the audit, showed assets of $3,007,349.28 as "adjusted", and "estimated" at $2,121,428.67. They had him prepare a revised Exhibit 11 subsequent to his testimony, showing assets of $1,756,375.84 (Tr. 415) by eliminating some of the assets which he had included in Exhibit 10.

Rejection of Proposed Findings: As stated above, the findings of the court that Young was insolvent was based on improper valuations, on elimination of certain assets, which should be included, and on the inclusion of an obligation in excess of $2,500,000, which should have been eliminated, and the $275,000 which was given in settlement.

Due to the fact that the only evidence as to the value of the 112,885 shares was the testimony of the witness White that was based on a "market quotation" of $6 per share on May 31, 1942, without proving any sales nor a normal market, counsel for petitioners requested the court to make certain findings and to disregard such valuation (Tr. 76-87). The court refused to hold as requested by the petitioners, that in the absence of any other competent proof as to the value of the securities, the book value of $22 per share and the earnings of the corporation were the determining factors in fixing the value of the stock.

The court refused to find that the 1931 contract between Leonard A. Young and his wife for the transfer of the major part of his assets and the creation of a liability of over $2,500,000 at a time when he owed the corporation $720,000 and when he claimed to have been

insolvent, was invalid (Tr. 86). It held on the contrary that the contract between Young and his wife was valid, that the assets were properly transferred, and included the liability among his liabilities, whereby it concluded that he was insolvent.

The court also refused to hold as a proposition of law (Tr. 86) that proof of a market quotation of a small number of shares is no criterion to establish the value of tremendous blocks of shares which vested the control of the company in the holder of the shares. It also refused to hold that while the price at which the stock is sold on the exchange may have some probative value it is not conclusive evidence, and there should be established the facts that the market was normal and the sales were large enough in order to reflect the true market conditions of a willing buyer and willing seller. It also refused to hold as a proposition of law (Tr. 87) that the net fair value of corporate assets and its earnings are relevant factors on the value of its capital stock.

Denial of Intervention: While on one hand the court determined that it had no jurisdiction to permit the intervention, because of the alleged limit on its jurisdiction by the mandate of this Court, nevertheless the court also decided to deny the intervention on the merits, as it found that the charge that the petitioners were not adequately represented by the attorneys for the plaintiff was not sustained (Tr. 92). This finding is contrary to the evidence, for it appears that the attorneys for the plaintiff recommended the acceptance of the settlement in 1940 based upon an unverified audit, and it was known to them that the auditor made no examination and relied on the sworn statement of the person whom they charged to have committed the fraud.

I.

The Finding of the Court That Leonard A. Young Was Insolvent as of May 31, 1942, Based on Assets of $1,756,375.84, Is Contrary to the Undisputed Facts and Is Founded on Erroneous Legal Principles in Determining Values, and the Court of Appeals Clearly Erred in affirming the Decree.

The principal witness upon which the findings of the court are based is Hugh White, who made the 1940 and 1942 audits and who testified in support of his audits. The court found that as of May 31, 1942, the value of the defendant, Leonard A. Young's assets was $1,756,375.84 and his liabilities were $5,808,455.57, and he was, therefore, insolvent (Tr. 89). The finding of the value of $1,756,375.84 was made *in spite of Young's own statement that his assets consisted of* $2,036,007 *as of March* 31, 1942 (Tr. 387). This finding was based on *false legal principles* concerning the determination of values. If the correct law was applied, it would lead to the irresistible conclusion that he is solvent.

(a) The valuation of the 112,885 shares in the Corporation at $6 per share based on the market quotation on a single day, in a fluctuating and abnormal market, was clearly improper, and it was the duty of the court to find that the value was $22 per share.

The finding that the total value of Young's assets was $1,756,375.84 *hinged* on a "market quotation" of $6 per share on May 31, 1942. The 112,885 shares in the Corporation were valued at $677,310.00 (R. 165) instead of $2,483,470.00 if the true test were applied, being the *actual value*. If the value of the shares be taken at the true value instead of the "market quotation", the items "Securities owned" (R. 415) would thereby be increased

by $1,806,160. The assets would be increased, therefore, through *this item alone* from $1,756,375.84 to $3,562,715.84. There were also other assets which the court either excluded or did not properly fix the valuation. The court's finding as to the assets and liability was based on the audit of the accountant White (Tr. 415; Ex. 11). Real estate having a book value of $149,583.05 was estimated by him at $48,108.29 when he prepared Exhibit 10 and testified in court (Tr. 406). This value was decreased after he rendered his testimony, by Exhibit 11, to $41,120 (Tr. 415). Property which was carried in joint names, having a book value of $380,553, was included in Exhibit 10 on which he testified for the plaintiffs as valued at $237,160 (Tr. 406) for the reason that *such property was still carried among Young's assets*. This property was completely *eliminated* subsequent to his testimony in Exhibit 11 (Tr. 415). There was also excluded from Young's assets the property which he transferred to his wife under the 1931 contract at $1,621,906.58 and admitted to be now worth at least $219,101.88 (R. 418).

The only evidence as to the value of the 112,885 shares at $6 per share was that of the accountant White (Tr. 165) that he estimated the value of these shares at the *quoted market* on May 31, 1942, at $6 per share amounting to $677,130. *He conceded* that he had *no personal knowledge of the real value of the stock* and merely testified to the "market quotation" (Tr. 181) and to the *computation* of the amount. No evidence of *any* sales in that market was offered. There was no evidence tending to show that the market was normal.

The evidence showed the *range* of the market between 1929 and 1941 (R. 342-3). The market was *continually fluctuating*, ranging as high as 59 and as low as 3. Dur-

ing 1931 it fluctuated from 29 to 6. It reached $53 in 1935 and dropped to 19 in the same year. The following fluctuation of the market is shown by the record (Tr. 342-343):

Year	High	Low
1929	59¾	33½
1930	47	19
1931	29	6
1932	11⅞	3
1933	19.1	3½
1934	22¾	13
1935	53⅛	19
1937	46⅝	12½
1938	25⅞	9⅜
1939	21¼	9½
1940	14	6¾
1941	12¼	9⅛

The evidence showed that the actual value of the stock was $22.11 per share (Tr. 40). Leonard A. Young, as President of the corporation, stated in the Annual Report of 1941 (Tr. 422):

> "The annual statement generally reflects **the finest position your corporation has enjoyed for years.** The financial position of the corporation was strengthened materially during the year from earnings. Long term indebtedness was reduced $200,000. A dividend of $1.00 per share was paid on April 25, 1941 and working capital increased over $900,000. **Consolidated profit** before taxes on income for the year ended July 31, 1941, amounted to $2,426,765.41, **equivalent to $5.94 per share of common stock outstanding. Net profit after all taxes on income amounted to $1,368,248.35, or $3.35 per share.** No comparison of operations for the 12-month period ended July 31, 1940 is available; however, for the 7-month period then ended final profit amounted to $488,158.32 or $1.19 per share common stock outstanding, and for the 12-month period ended December 31, 1939, $207,272.62 or $0.51 per share."

That the "market" did not have any relation to "value" is evident from the fact that in the year 1939 when the profit was $207,272.62 or "$0.51 per share" the market quotation was 21¼ high and 9½ low, while in 1941 when the profit was $1,368,248.35 or "$5.94 per share", the market was 12¼ high and 9⅛ low. *It is absurd to say that a share which had a profit in the year* 1941 *of* $5.94 *was only valued* $6.00. Why should the same share which earned a profit in 1941 of $5.94 be valued $6 May 31, 1942 because of a market quotation on that day?

The book value of $22.11 per share was arrived at by *deducting from the assets of the company the total amount of liabilities,* exclusive of capital stock and surplus (Tr. 329). There is, therefore, on the one hand a mere "market quotation", without proof of any sales, and without proof of the existence of a normal market, with a *fluctuating market in each year,* and, on the other hand, *there is the proof of the actual value of the stock based on earnings and on the value of the assets, less liabilities.* It was clearly erroneous to base the valuation on the quoted market and to sustain the finding on the ground that it was sustained by "substantial evidence" where the evidence was wholly incompetent.

(1) Market quotations in a fluctuating abnormal market do not establish value of corporate stock.

While a court may consider market quotations of *actual sales in a normal market* to determine value of securities in connection with the consideration of other elements pertaining to such value, *no court may eliminate all other elements and adopt a market quotation of a fluctuating abnormal market,* without proof of actual sales, as a test of the value of the securities.

In *Wilder* v. *Robinson*, 50 App. Div. 192, the Appellate Division of New York said:

> "It is quite true that market quotations under certain circumstances are **some** evidence of value, but **they only have that effect where they are based on actual sales of the stock quoted.**"

In *Otis & Co.* v. *Grimes*, 48 P. (2d) 788, the court said at page 790:

> "**Various considerations fix the stock market quotations. For example, the assets and earnings of the corporation are considered,** and sometimes **stock manipulation,** taken in connection therewith and occasionally independent thereof, **exercises an important influence upon stock market quotations. * * * The quoted price of one may be due to solid worth; that of the others to manipulation by speculators.**" (Emphasis ours.)

In *Lebold* v. *Inland S. S. Co.*, 82 F. (2) 351, it was said:

> "The determination of value entails *necessary consideration of all elements that enter into value*—costs of physical assets, additions, depreciation, * * * market price, earnings, the chance of successful operations, and prospects of continued earnings. *From such evidence as to all of such elements, true valuation is to be determined.* The stock of many corporations sell far less than their book value, which ordinarily are costs, plus additions, appreciations, less depreciation and obsolescence." (Italics supplied.)

Here, all of the important elements which enter into valuation were *excluded* by the court and the only basis for the value of the securities was the "market quotation" on the particular day of May 31, 1942, *without evidence of a single sale at such a quotation.*

In *Kohle* v. *Mt. Vernon Trust Co.*, 22 N. Y. S. (2) 454, the court said:

> "The sales of securities which are dealt on any public exchange, **are not necessarily the measure of**

> the **actual value** of such securities especially in a depression. * * * For many years the bank examiners, both federal and state, have recognized the fact that **quotations in public markets do not necessarily reflect the true value of securities.** The prices on public exchanges have been known to be depressed by market manipulations and to be inflated by other manipulations."

A glance at the market range (Tr. 342) showing fluctuation during each year demonstrates the truth of the statement and it appears in this record (R. 56-57) that the *dominant officer* purchased stock on margin for the purpose of *manipulating* the market.

The rule was also stated in *Universal Insurance Co.* v. *State Board of Tax Appeals,* 118 N. J. Law, page 538, 193 Atl. 915, where the court said:

> "In the words of our Court of Errors and Appeals in *Newark* v. *Tunis,* 82 N. J. Law, 461, 81 A. 722, 723 (opinion by Parker, Jr.), '*true value is not always to be ascertained by reference to selling price;* * * * *special circumstances may increase or depress market value without affecting true value or vice versa*'."

The approval of the findings by the Court of Appeals which is based on alleged "substantial evidence" when the evidence was clearly incompetent is not in accord with the decision of this Court in *Virginia* v. *West Virginia,* 238 U. S. 202-212. A mere market quotation is not "market value" (*Wheaton* v. *Lynch,* 60 N. Y. 469).

(2) The value of a large block of stock giving control of the corporate affairs to the owner thereof cannot be measured by market quotations of small quantities of stock.

It should be noted that Young was in control of the corporate affairs through the ownership of the 112,885

shares in the corporation. The accumulation of such a large block of shares by him is *what kept him in control* of the corporation during these years. This enabled him to draw over $300,000 in the year 1941 from the corporation. *The value of such a large block of stock vesting control in the owner thereof cannot be measured with the value of small numbers of isolated shares of stock* which may create a market quotation. (*Cleary* v. *Hegley*, 277 N. Y. S. 63, 73.)

(3) The affirmance of the decree is based on misconception of the law and there can be no substantial evidence to support findings when such evidence was incompetent.

The witness White who prepared his audit on valuations as of May 31, 1942, testified that the market quotation of the 112,885 common shares were valued on that day at $6.00 per share (Tr. 165). The market was closed on May 30th and May 31st, 1942, because of legal holidays and there was no market quotation on such days (Tr. 437, 438).

That a "market quotation" at an *isolated* day was incompetent as evidence to establish the value of the stock appears from the market quotation of April 6, 1943, which was presented to the Court of Appeals on the oral argument of April 9, 1943 (Tr. 430). It ranged from 12¼ to 12¾. On the day of the filing of the petition for rehearing, May 6, 1943, the market ranged from 13 to 13¼. It is evident that the selecting of an isolated day of a market quotation was highly improper. This Court may take judicial notice of the market quotations as of January 5th and 6th, 1944 and January 15th, 1944, the date of the preparation of this petition when the market was 15½ and 15⅜. The fallacy of the admissibility of

the market quotation on the isolated day appears from the fact that there was never a steady market in dealing in this stock. There were fluctuations in the same year from 12½ low to 46⅝ high. In another year it fluctuated from 29 to 6 (Tr. 342-343). Under no theory may an accountant select an isolated day when the market quotation was at its lowest and base his valuation of the stock in arriving at the assets.

It is obvious from the foregoing that the statement in the opinion of the Court of Appeals that the "findings" of the District Court "are supported by substantial evidence," is based on *a misconception of the law.*

While it is our contention that under no theory could the mere market quotation be resorted to as a foundation for valuation without considering the other elements, yet as an illustration we desire to point out that instead of taking the arbitrary day of the non-existent market on May 31, 1942, if January 5 or 6, 1944, were selected then the finding of "insolvency" would have to be changed to "solvency".

If the "market quotation" of January 5th and 6th, 1944, were used instead of May 31, 1942, the "insolvency" would be converted into "solvency". The marginal notes of the auditor (Tr. 415) state that the "insolvency" to the extent of $4,052,077.73 as of May 31, 1942, would be changed if there be added to these assets the items of $111,000.00 and $219,101.88, and if there be eliminated the liability to his wife of $2,554,429.33, and the deficiency would be reduced to $1,167,546.51. This deficiency was based on the market quotation of $6.00 per share. If the 112,885 shares be valued at 15½, the market quotation as of this date, the 112,885 shares would be valued at $1,749,717.50. Instead of the valuation of $677,310.00,

there would be an increase of $1,072,407.50. Deducting this amount from the alleged deficiency of $1,167,546.51, there would be a surplus of $95,139.01. There should be added to the surplus the $275,000.00 which was figured in the liabilities and which amount should have been excluded because the liability was created for the purpose of the settlement. The assets above the liabilities would, therefore, be $370,139.01. This is upon the assumption that the valuations of the other properties were correct, which we, of course, do not admit.

(4) The net fair value of the corporate assets and the earning capacity of the stock was the determining factor of the value of the stock which the court improperly failed to consider.

The auditor for the corporation testified how he arrived at the valuation of $22.11 per share. His testimony was entirely ignored by the court. He testified (Tr. 329) that after he deducted the liabilities from the assets the *net assets showed a valuation of* $22.11 *per share.* The earning capacity of the shares on the basis of $5.94 per share during the year 1941 was also ignored and the only element that the court considered was the "market quotation" on a particular day, without actual sales, and without proof of a normal market. *This was highly improper.*

Mr. Justice Brandeis, in *Ray Consolidated Copper Co.* v. *U. S.*, 268 U. S. 373, 45 S. Ct. 526, 528, says:

> " * * * The capital stock of a corporation, its net assets, and its shares of stock are entirely different things. * * * The value of one bears no fixed or necessary relation to the value of the other. * * * *The net fair value of the assets was clearly a relevant fact bearing upon the value of the capital stock.* He may have given much consideration to the selling

price of the shares, and have concluded that, under the conditions prevailing in the year 1920, **the average price at which relatively small lots were sold on the Stock Exchange was not a fair indication of the value of the capital stock.** (Emphasis ours.)

The assets of Leonard A. Young, which the court found to be $1,756,375.84, should be increased by the *actual value* of the stock at $22 per share instead of $6. As a result of the increase in *this item alone* the assets are $3,562,715.84, *exclusive of the other assets.*

(b) In determining the value of Young's assets, the court improperly excluded certain assets and the value of the other assets was improperly determined.

The testimony of the experts for the respondents was that Young held jointly with his wife real estate valued at $111,000 (Tr. 415, 417). The property, which he transferred to his wife in 1931, then valued at $1,621,906.58, was now valued by them at $219,101.88 (Tr. 415, 418). The total of such assets, which was eliminated from the account, was $371,221.88. The court excluded these properties because they were held in *entirety* between Leonard A. Young and his wife (R. 89), or because of the transfer. When the property was pledged in 1931 Leonard A. Young stated *he was their owner* (R. 415). His wife merely *joined because of her dower right* (R. 419). The placing of the property in entirety at the date when he owed $720,000 to the corporation and when he was unable to pay it, was *void*, as held in *Jaffe* v. *Ackerman*, 279 Mich. 304.

Leonard A. Young transferred to Ola Young, his wife, in 1931, when he owed the corporation $720,000 and when he claimed to have been insolvent (R. 57), property

then valued at $1,621,906.58 and now worth at least $219,101.88 (Tr. 415). It included furniture and fixtures of the Boston Boulevard property at $345,353.77, which the experts say is now worth $25,000.

All of these properties were pledged by Leonard A. Young and Ola Young as collateral security with the United States Steel Corporation under the collateral note (R. 415) *and the collateral was released by the fraudulent transaction whereby* $750,000 *of the corporate funds were used to pay the individual debt of the President of the corporation and to obtain the release of the collateral.* By reason of the fraud practiced on the corporation by Leonard A. Young and his wife, Ola Young, they were both Trustees for the corporation (*Flannery* v. *Flannery Bed Co.*, 108 F. (2) 539), and *they received the property in trust.* Therefore, all of this property should have been included in the valuation.

(c) The court improperly found that the notes and accounts receivable were valued at $334,425.00.

Plaintiff's Exhibit 10 showed the book value of the "notes and accounts receivable" at $594,975.88 and their estimated value at $454,897.83 (Tr. 399). In Exhibit 11 the same accountant estimated the value at $334,425.00 (Tr. 415) which the court *accepted* in determination of the total value. The estimated value of $454,893.83 eliminated the item of $30,953.28 due from Stewart, the Secretary and Treasurer of the corporation, whom we have shown to have drawn a salary of $12,000 per year (Tr. 261) and against whom no attempt was ever made to collect it (Tr. 269). The estimated value should, therefore, be increased by that amount.

In determining the value of these securities at $334,425 the auditor figured the $228,472.83, which was due to Young from the L. A. Young Company, at a value of $108,000 (Tr. 415, Note C).* This was based on the testimony of a witness for the respondents (Tr. 330) that the Company was then valued for liquidation purposes at $250,000; that the liabilities of the company consisted of $141,000 to outside creditors, and the liability to Young of $228,472.83, which then amounted in excess of $243,000; that it required $384,000 to pay the debt in full, and there would only be left on the assumed value of $250,000 the sum of $108,000 to apply on this liability (Tr. 330). The entire debt of $243,000 was fully collectible and should have been included in full against the assets. This is shown by Exhibit 10 (Tr. 414) which contained a summary of the consolidated balance sheet of L. A. Young Company and subsidiary. The assets aggregated $608,252.34 and liabilities were $464,312.88, including the liability to Leonard A. Young of $343,897.83. *Based upon this balance sheet the entire claim was fully collectible.* It was the duty of the court to consider the *entire claim* fully collectible instead of figuring it $108,000.**

(d) The findings are based on testimony of witnesses who were disqualified and their evidence is of no probative value.

The star witness White testified to values based on tax assessment (Tr. 180). His audit was also based on such valuation (Tr. 406).

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* This account receivable which is admitted to be worth at least $108,000 was included in the assets said to be valued at $5,000 (Tr. 380).

** Leonard A. Young told the auditor when he prepared the 1942 audit that the account was collectible.

Alcide P. Cheuvin testified as to the value of personal property (Tr. 319). He was in charge of the Real Estate Tax Department of the Detroit Trust Company. He testified that the personal property in the Home at Boston Boulevard, which was valued at $345,357.77 in 1931 (Tr. 384), was now valued at $25,000 (Tr. 319). On cross-examination he described the property consisting of furniture, rugs and draperies, piano, etc. He could not tell what kind of a piano it was. He was asked at how much he appraised it and answered (R. 320):

> "It is rather difficult to appraise that house—the furniture in that house, piece by piece, in other words, that would take weeks."

He said he "lumped" all the property together and he appraised the personal property in the same manner as he did "to confirm personal property assessment" (Tr. 321). He was asked whether he knew the value of the davenport and he said he had "no idea" and "It is very beautiful. It is very fine." He never bought or sold a parlor set of this type and did not know its value. He did not know what the "liquor cabinet" was worth and he did not check whether it was filled with liquor. There were "antiques" such as floor lamps, a marble top table, a "very fine rug". He did not know their values (Tr. 321). He was asked (Tr. 321):

> "Do you know what the entire furniture would be worth? Did you have it appraised how much it cost?"

He said "No, I have no idea what it costs now and would hesitate to state how much depreciation would be". At last he was asked if there was an oil painting there and he answered there were several paintings, probably 20. He could not tell what they were, by whom they were made, nor their value. Realizing their dilemma, counsel for the plaintiff recalled the expert Thomas (Tr. 323) to

testify as to the value of the personal property. But he was honest enough to say that he made no examination thereof and could not testify.

Another expert, Walter R. Slater, an accountant, testified on behalf of the plaintiff concerning the value of L. A. Young Company and he made a survey of its assets and liabilities (Tr. 329). He said that the fair value on liquidation was $250,000. There were liabilities to L. A. Young of $243,000 and to other creditors of $141,000 and if other creditors were paid in full there would remain $108,000 to pay on Young's debt (Tr. 230). The assets consisted of $10,000 cash, $125,000 accounts receivable, and inventory of $260,000, besides real estate valued at $40,000. Adding up these items, they, of course, exceeded the $250,000 valuation and were sufficient to pay the claim of Young of $243,000 in full, which was estimated among the asset which was only worth $5,000. The witness was asked on cross-examination (Tr. 332):

> "In testifying to the value of the machinery, did you testify as to the value of your own knowledge?"

He was evasive, saying:

> "I have seen all of the machinery in that plant".

His attention was called to the question and asked directly to answer of his own knowledge whether he testified of his own knowledge, at which time the court volunteered with an explanation, saying (Tr. 332):

> "What he means, that the value of anything is a question of opinion, isn't it "

The witness obtained a clue and said: "I believe so". The question was then reread to the witness and petitioners' counsel insisted that he answer the question. He finally stated that he had no actual experience in buying and selling machinery. He did not obtain any appraisal of its

value and it was merely "a guess" and the real estate was estimated at the book value. He figured the liabilities as shown on the books and for liquidation purposes and not as a going concern. This is the "substantial evidence" which the *per curiam* opinion stated supports the findings of the court.

II.

The Finding That the Liability of Leonard A. Young Was $5,808,453.57 Which Included the Alleged Liability of $2,554,429.33 to His Wife, Created at the Time When He Owed the Corporation $720,000 and When He Claimed to Have Been Insolvent, Is Based on a Clear Misconception of Law and It Was the Duty of the Court to Exclude the Alleged Liability on the Ground That It Was Fraudulent As to the Corporation.

The finding of the court that Leonard A. Young was insolvent, because of his liability in the amount of $5,808,453.57, was based on the audit of White (Tr. 415), and on Exhibit 11, which he prepared *subsequent* to the time when he testified and which is at *variance* with his Exhibit 10, which was the basis for his testimony. This exhibit contained among "notes payable" the item of $2,816,605.17. The notes payable as to this item is described in Exhibit 10 (Tr. 410) and *it included the* $275,000 *which was borrowed by Young from the United States Steel Corporation, with which to pay his settlement on the reversed decree* (Tr. 70, 197, 198)! It also contained, under the heading "Accounts Payable", $2,818,292.84 (Tr. 415). This item included the alleged liability to his wife in the sum of $2,554,429.33 shown in Exhibit 10 (Tr. 411).

The court determined that the alleged debt to her of $2,554,429.33 was a valid obligation (Tr. 89) notwithstand-

ing the fact that *at the date of its creation he then owed the corporation* $720,000 *and claimed to have been insolvent* (R. 57). In treating this obligation as valid the court stated that *petitioners had the burden* of proving the invalidity thereof and that they failed to prove it. *The conclusion of the court was based on its misconception of the law* and the Court of Appeals clearly erred when it concluded that it correctly applied the law. If this were a trial on the proposed complaint of the intervenors to set aside the claim, the burden would have been on them to prove the fraud. The court did not hear the matter on such a complaint. *The matter was heard on Young's claim that he was insolvent as a basis for the settlement.* The District Court ruled in this case that the *burden was cast upon the proponent of the settlement* (Tr. 151). Respondents, therefore, had the burden to show that the transfer of the assets and the creation of the debt which made him insolvent was fair and equitable.

Petitioners called the court's attention to the admissions of the defendant Young in his answer (Tr. 270) which appears in the former record which is a part of this record as Objector's Exhibit 3, wherein he stated the following (R. p. 57):

> "That thereafter, in October of 1931, this defendant's loans were called, brokerage houses demanded additional margin, and defendant's entire fortune was swept away. As a result of the market crash, this defendant was unable to meet his obligations and was at no time since that period able to pay the sum of $720,000 which he had previously borrowed from L. A. Young Spring & Wire Corporation on what, at the time of making said loan, was more than ample collateral, except through the transfer to it of the stock of Detroit Moulding Corporation in the manner hereinbefore alleged."

In view of his statement that he was *insolvent from October,* 1931 *and thereafter,* and the fact that the contract with his wife transferring his assets to her and creating the liability of $3,500,000, of which the alleged present balance of $2,554,429.33 is said to be outstanding, petitioner asked the court to hold *as a proposition of law* (Tr. 86) that the agreement between Leonard A. Young and his wife, Ola Young, of November, 1931, at the date when he claimed to have been insolvent and to have been indebted to the corporation in the sum of $720,000, payment of which he was unable to meet, and the transfer of all of his valuable assets to his wife on the date of his confessed insolvency, tinged the agreement with fraud, and neither the liability nor the transfer of the assets may be considered as valid upon the issue of the insolvency of Leonard A. Young, although in order to declare it invalid, Ola Young is an indispensable party.

The court clearly erred when it held to the contrary and excluded the assets and included the liability. A conveyance made and an obligation incurred by a person who is or will thereby be rendered insolvent, is fraudulent as to existing creditors regardless of actual intent to defraud (*Iden* v. *Huber,* 259 Mich. 3, 6). Here, Young owed the corporation $720,000. He then claimed he was unable to pay. He conveyed his major assets to his wife and created the obligation whereby he actually made himself insolvent. *The transaction was therefore, fraudulent regardless of any intent.* It is the rule in Michigan that "when the questioned conveyance renders the grantor insolvent, fraudulent intent may be inferred". (*Bentley* v. *Caitle,* 289 Mich. 74, 78.)

The evidence in this case shows that after the alleged transfer of the assets the transferor, Leonard A. Young, "continued to retain the 112,885 common stock" (Tr. 325, 326), "and he drew $65,000 in dividends as late as 1941". The real estate which he transferred to his wife in 1931 *is still carried on his books as his property* (Tr. 237). This is the "badge of fraud" which makes the transaction fraudulent and void. (24 Am. Jur. page 210 § 54.) In the instant case the alleged consideration of Mrs. Young for the conveyance to her and the creation of the obligation was on the contention that he improperly collected the dividends and commingled it with his own funds. *The evidence is that he continued this practice thereafter.* The court held that such evidence was irrelevant although this was true as a matter of fact (Tr. 292). The rule in Michigan is the same. (*Township of Maple Valley* v. *Foley,* 113 Mich. 622, 625; *Anderson* v. *Anderson,* 215 Mich. 80, 84). In 68 A. L. R., page 306, abundant authorities are cited supporting this rule.

(a) Even if the burden was cast on petitioners to show the invalidity of the agreement, such burden was met and the court erred in finding that there was no evidence tending to show its invalidity.

Even if it be assumed for the sake of the argument that the burden was cast upon the petitioners to show the invalidity of the agreement, the court clearly erred in finding (Tr. 89) that there was no such evidence. Petitioners filed interrogatories (Tr. 35) which were answered by Young (Tr. 38). The agreement of November 19, 1931, between Young and his wife was attached as an Exhibit to the answer (Tr. 48). This agreement recited that the consideration for its execution was that Leonard A. Young "without the knowledge or consent of his wife, Mrs. Ola Young", pledged all of Mrs. Young's stock then outstanding which in fact stood in the name of the Lay Improvement Company together with a portion of his

own stock under certain instructions to the pledgee (Tr. 52). It was stated therein that of the 98,633 of the shares in the Corporation, 97,600 belonged to her and were transferred to the Lay Improvement Corporation in consideration of the issuance of its capital stock; that she was, therefore, entitled to $50.00 per share for the 97,600 shares; that she was also entitled to additional shares of 20,770 which were declared as a dividend, making a total of 103,852 which belonged to her, at a valuation of $50.00 per share. The agreement also stated that some of the stock was sold when the pledgee failed and that only approximately 15,000 shares may be recovered; that on the day when the pledgee became insolvent the market value of the shares was $35.00 per share, and Mrs. Young then *"renewed her demand upon her husband for the return of the stock or the value thereof"*.

It further stated that *for the past six or seven years her husband collected the dividends on her stock amounting to* $783,500, on which he paid the income tax and he commingled the dividends with his own funds; that 27,694 of her shares were sold at $26.50 per share and that her husband owes her $733,891.00; that there remained belonging to her 103,852 shares which *he had improperly pledged,* and that the value thereof was $50.00 per share, making a total valuation of $5,192,600.

The alleged claim of Mrs. Young against her husband therefore consisted of the three items: (1) proceeds of the sale of some of her stock in the amount of $733,891.00; (2) 103,852 shares in the Young Corporation at $50.00 per share which he pledged without her consent, the value thereof being $5,192,600; and (3) dividends collected thereon of $783,500 aggregating $6,709,991 with interest at 5% less any income taxes which he had paid out,

"which amount was impossible to determine because he commingled it with his own funds" (Tr. 53). It was stated therein that Mr. Young contended that the value of the stock should be figured at $35.00 per share instead of $50.00* and it was, therefore, "agreed that Mr. Young is indebted to Mrs. Young in the sum of $3,500,000, which Mr. Young is not now able to pay but is willing to turn over to Mrs. Young certain properties to apply on said indebtedness and Mrs. Young is willing to accept said properties" as per list contained therein (Tr. 54). The property which was turned over consisted of stocks and bonds and real estate taken at a valuation of $905,933.80.

The contract recited (Tr. 62) that Young had pledged with the United States Steel Corporation 115,325 shares of the Young Corporation for an indebtedness of $2,594,000 together with other collateral set forth in an agreement of October 24, 1931, and he, Leonard A. Young, therefore, *sold to his wife, Mrs. Young, all of his right, title and interest into said collateral.* This agreement stated: "that the foregoing is a *complete adjustment* to the extent of the agreed application of properties this day transferred or intended to be, *of all matters and differences between Mr. and Mrs. Young and of a statement of balances due,* and that the same shall be binding upon the parties hereto and their heirs and assigns" (Tr. 63).

On May 14, 1935, a supplemental agreement was entered into between them, after Mr. Young succeeded in cancelling his obligation in excess of $994,000 to the corporation and received the return of the collateral includ-

* The market quotation in 1931 ranged from 29 to 6 (R. 342). They did not choose the $6.00 valuation in that contract as was done on the issue of his insolvency.

ing the 40,983 shares of the corporation whose value exceeded $400,000. *He and his wife then stated in the supvious agreement there was no complete accounting betwee tween them* or understanding and *he, therefore, transferred to her the additional* 33,000 *shares of the stock which he received from the corporation* upon the cancellation of his debt together with the other collateral (Tr. 64; Ex. 3).

The two agreements speak for themselves and the fraud is apparent. The falsity of the statements contained in the two agreements concerning the alleged considerations appears therefrom. **The agreements were drawn in fraud of the corporation which was then the creditor of Leonard A. Young, its dominant stockholder and officer.**

Leonard A. Young owed $797,296.75 on a trading account with Otis & Company, and among the collateral he had pledged 29,900 in shares of the Young Corporation (R. 367). He also owed on another trade account with Paine Webber & Co. $59,847.41, and among the collateral there were 2,375 of the shares of the corporation (R. 368). He further owed to the Union Guardian Group of Detroit $1,725,000 and there was pledged 71,200 shares of the corporation aggregating 103,475 shares. On October 23, 1930, the United States Steel Corporation addressed a communication to White, Weld & Co. (R. 367) stating that the United States Steel Corporation, by the request of Mr. Young, would take over all of the foregoing accounts and collateral and would advance an additional $1,000,000 cash for his benefit so that all of his loans may be consolidated. The transaction was consummated by an agreement dated the following day—October 24, 1930 (R. p. 373) whereby Young was to execute a collateral note for $2,594,026. Such a note was executed by

him (R. 379) and *all of the* 103,475 *shares, together with other collateral, was deposited as security for said note* (R. 381). This *refutes* the entire story of the agreement as *it demonstrates that the shares were not sold on the failure of the brokerage house,* but were pledged under a consolidated loan with an additional credit of $1,000,000. This loan was renewed on April 24, 1931 (Tr. 382) and the new note was given at that time for $2,594,026 (R. p. 387) and the number of shares was increased to 112,825 (Tr. 390).

Contrary to the statement contained in the agreement that Mr. Young pledged the shares *without the knowledge of his wife* and that she did not consent thereto there appears in the record a renewal note for the $2,594,000 dated October 24, 1931 (R. 390) with Schedule A attached thereto **containing 115,325 of the shares including the 98,633 shares of the Lay Improvement Corporation and this note was described in an agreement entered on October 24, 1931, to which Ola Young was a party** (R. 414). It expressly referred to Schedule A (R. 417) which contained the stock and collateral and it stated that Mr. Young represented (R. 145) and (R. 418) "the stock of Lay Improvement Corporation, mentioned in said Schedule E, is all of the outstanding capital stock of Lay; that Lay is entirely owned or controlled by him • • • and that he has been duly authorized to pledge all of the stock" and it stated (R. 419):

> "Ola Young, the wife of Mr. Young, joins in the execution of this instrument to bar, in favor of the corporation, or right of dower in said real estate and to evidence her agreement to this instrument insofar as her interests in said real estate are concerned."

It is, therefore, clearly demonstrated that *she knew that the stock was pledged and consented to the pledge there-*

of. This agreement is expressly referred to in the subsequent agreement of November 9, 1931.

Notwithstanding the alleged sale of his equity in the stock which was pledged as collateral and the alleged claim as a consideration for the transfer in consideration of the $3,500,000 debt that he had previously without her consent appropriated the dividends on the stock, *he continued thereafter to collect the dividends and collected in the year* 1940 $25,000 *in dividends and in the year* 1941 *he collected* $65,000 *in dividends.** Prior to the transfer he collected the dividends and this was alleged as one of the considerations (Tr. 53) for the creation of the liability, but after the transfer of the assets *she permitted him to collect the dividends up to this time.* This is a *badge of fraud* which makes the transaction void (24 Am. Jur. §54; *Clark* v. *Lee,* 78 Mich. 222; *Hopkins* v. *Bishop,* 91 Mich. 328).

(b) The contract between Leonard A. Young and his wife relating to the 40,893 shares in the corporation was fraudulent and void.

The evidence is undenied and it is *conceded* that at the date of the execution of the 1931 agreement Leonard A. Young *owed the corporation* $720,000 which was secured by 33,000 of the shares of the corporation and there were other shares in the amount in excess of 10,000 shares secured for an obligation of $286,650.12 and by other collateral which was *then valued in excess of* $400,000 (R. pp. 28-29, 41). On December 30, 1933, a person by the name of "L. M. Whitney", *who was in reality Leonard A. Young* (R.I. 232) made a proposition in the name of "L. M. Whitney, Inc." (which corporation was organized by Leonard A. Young) (R. 164) to the L. A. Young

* See also the statement of the court on this point (Tr. 292).

Spring & Wire Corporation wherein he stated that the Whitney Company owned all of the capital stock of the Detroit Moulding Corporation and proposed to transfer its capital stock to the L. A. Young Spring & Wire Corporation in consideration of its surrendering the note of L. A. Young for $720,000 and the notes of certain employees in the amount of $277,605.25 together with the 33,000 shares deposited under Young's note, and the shares deposited under the other note with the other collateral deposited thereunder. The proposal stated (R. 42):

> "In other words you are to deliver to us all of the obligations of officers and employees; the subject matter of those two items in your published balance sheet of December 31, 1933, together with the collateral appertaining to such particular loans, and upon the endorsement and assignment without recourse of such notes and collateral, we will deliver to you all of the capital stock of the Detroit Moulding Corporation, free of all liens and encumbrances with transfer stamps affixed."

Here was a proposition in the name of a *fictitious person* by the *dominant officer* of the L. A. Young Spring & Wire Corporation to the corporation which he then controlled *to surrender collateral admittedly then valued in excess of* $400,000 *and to cancel his personal obligation of* $720,000 *together with the obligations of the other officers in consideration of the capital stock of the Detroit Moulding Company.* This proposition was accepted on January 9, 1933 (R. 48). The Detroit Moulding Company in turn was organized by Leonard A. Young and its assets consisted of machinery and equipment which it purchased at $22,500 on one occasion and $13,500 on another occasion (R. 48) and which was paid with checks drawn from the Young Spring and Wire Corporation (R. 163). Its

appraised fiscal assets were $159,805.06 (R. 49) and at the date of the proposal on December 31, 1933 it owed to the L. A. Young Spring and Wire Corporation $142,838.06 (R. 163). **It goes without saying that this transaction whereby the corporation was deprived of the $400,000 in assets and the debt of $994,417.16 cancelled under the foregoing circumstances was fraudulent and void under the theory that a court of equity will pierce through the form of the device employed and tendered through the corporate disguise and annul such transactions** (*Fleischhacker* v. *Blum,* 109 F. (2) 543, 547) and the dominant officer and stockholder *had the burden of showing the inherent fairness of the transaction,* which he failed to do (*Raymond Eldridge Co.* v. *Security Realty Investment Co.,* 91 F. (2) 163; *Pepper* v. *Litton,* 308 U. S. 295, 306).

Ola Young, the wife of Leonard A. Young, acquired the 33,000 shares from her husband *with knowledge of all of these facts* as they all appeared in the agreement under which the shares were transferred (Tr. 67). She does not stand in the position of an innocent purchaser for value and the alleged consideration is contradicted by the original agreement of 1931. She still has 14,157 of these shares that are *unpledged.* There are 87 shares in the Lay Improvement Company which are unpledged, and Leonard A. Young himself, under the findings of the court, is possessed of 8,804 shares. The total unpledged shares, therefore aggregate 23,048. If the valuation of $6 per share be the correct valuation, then the assets should be increased to $138,288.00. If the valuation of $22 per share be applied, then the assets should be increased to the extent of $507,056.00. The corporation was entitled to the return of the collateral which was transferred to Ola Young in fraud.

III.

The Earning Capacity of Leonard A. Young Demonstrates That He Was Able to Pay His Obligations As They Matured and That He Was Not Insolvent.

The record shows that Leonard A. Young was 65 years of age; that he earned over $300,000 for the year immediately preceding the time when he was alleged to be insolvent (Tr. 413). He was able to meet each obligation as it matured and paid $200,000 in a period of 16 months to reduce his principal debts. Bearing in mind that through the ownership of his stock he controlled the corporation during all these years and was able to obtain a contract *even during the pendency of this suit* for a period of five years which netted him in excess of $148,000, besides $24,000 for expenses during the year 1941; that he drew $65,000.00 in dividends, during the same year, on all the stock which he alleged to have sold. Such a person, against whom no creditor ever had any difficulty in collecting anything, against whom no judgments were outstanding and who was able to get any credit he desired (Tr. 291) *cannot be considered insolvent* in the equity sense.

Petitioners proposed the following proposition of law (R. 86):

> "Insolvency in the equity sense means the inability of a person to pay his debts as they fall due in the usual course of business and the person who was able to meet all his obligations and to reduce the principal obligations to the extent of $200,000 in a period of 16 months, who was never refused credit, against whom no suits pressing collection of debts were ever instituted, and whose earning capacity under a contract which allows him $50,000 as a salary plus a bonus, under which he drew in the year 1941 in excess of $148,000, is not a person who may be insolvent under the law."

The court held to the contrary and the Court of Appeals held that the Judge ruled correctly. It cited no authorities in support of its conclusion. The authorities are overwhelmingly to the contrary. (*Denman* v. *Johnson*, 85 Mich. 387; *Jenkins* v. *Canfield*, 282 Mich. 277, 279; *Stone* v. *Dodge*, 96 Mich. 514; *Cincinnati Equipment Co.* v. *Degnan*, 184 Fed. 834, 840; *Martin* v. *Hertz*, 224 Ill. 83, 88).

IV.

Even If Young Was Insolvent There Were Assets on Which the Corporation Was Entitled to Impress a Trust to the Exclusion of Other Creditors Valued in Excess of $1,000,000 and the Settlement Was Therefore Unjustified.

There were 23,048 unpledged shares belonging to the corporation aggregating $138,288 on "market quotation" of $6 per share and $507,056.00 at $22.00, according to petitioners' valuation. *The corporation was entitled to impress such shares with a trust to the exclusion of all other creditors.* Some of these shares were in the possession of Young. His wife received some of them with notice of the fraudulent acquisition thereof by her husband. *They were both constructive Trustees.*

In addition to these shares there was also deposited with the corporation the stock in Bowen Products Corporation then valued at $475,053.00 and **now valued at $556,000 on which the corporation was entitled to impress a trust. This stock was still in the possession of the dominant officer who acquired same in breach of trust.**

The annual balance sheet of the corporation showed that there was deposited with the corporation the capital

stock of the Bowen Products Corporation having a book value of $475,053 as collateral security for a debt of $308,173.89 of an *"account with officer"* (R. 96). This balance sheet *did not disclose that Young was the officer.* On cross-examination his attention was called to this balance sheet and he was asked to state who that officer was. He answered (Tr. 277): "I think it is very clear". When he was again asked to state who the officer was he said, *"I would not judge myself capable of answering that. I think it is meant just the way it is printed".*

His sworn answer April 7, 1939 (R. 97) stated in answer to paragraph 32 of the complaint that he admitted *"that the official therein referred to is the defendant Young".* In that answer he also alleged that this stock "had an *actual* value of $475,053.00".

Mr. Young was then asked whether it was not a fact that this collateral was withdrawn from the corporation before the payment of the $308,173.89. Objection was interposed by his counsel (Tr. 271). The court asked Mr. Abrams to state the materiality of the question and it was stated that it is to bear out the contention that the corporation was entitled to impress a trust on such stock "regardless of whether Mr. Young may be insolvent". The court *conceded* that the issue was material on this inquiry (Tr. 279). A colloquy ensued between the court and counsel ending up with the *final admission by Mr. Cook on behalf of Mr. Young* (Tr. 280) *that this stock was still owned by Mr. Young.* Mr. Abrams then stated that the evidence will show that this stock was taken out before the debt was paid and that the corporation has a trust on such assets. At this moment the court declared a short recess and before proceeding further it referred to the opinion of this Court on the former appeal with reference to the judicial discretion and to a

definition of the term "solvency" and then stated (Tr. 281):

> "Now I think that those are the limitations within which this inquiry should proceed".

The securities of the Bowen Products Corporation which were pledged for the obligation of the $308,173.89 (R. 167) disappeared in the subsequent balance sheet of the year 1938 showing the balance of the debt of $198,698.42* and there was "no reference to any collateral for this loan or defense". *This collateral now appears to be in the portfolio of Leonard A. Young.* This debt was also to be compromised by the settlement. This collateral is, therefore, demonstrated to have been withdrawn by him from the Treasury of the corporation before he paid his debt. It was then valued according to his sworn answer $475,053.00. It is now valued $556,000 (Tr. 390).

The corporation is also entitled to impress a trust on all of the real estate which was pledged with the United States Steel Corporation as security for the loan and which was released to Mr. and Mrs. Young when the $750,000 of the corporate funds were used to pay the personal debt. A corporate officer who uses corporate funds to pay his personal debt and acquires collateral released by the payment of the debt with such funds stands in the position of a Trustee, and the corporation is entitled to be subrogated to the rights of the original creditor. *Whether the property stands in the name of Mr. Young or Mrs. Young or jointly is of no importance as all of that property was released from the collateral*

* The actual debt was $750,000 but the reduction first to $308,173.89 and then to $198,698.42 was obtained by means of "bonuses" which he obtained from the corporation which he dominated.

by the payment of the debt with the corporate funds, and the corporation, therefore, is entitled to impress it with a trust.

The present value of the property, which was released upon the payment of the $750,000, according to respondents' experts, was $111,000 and $219,101.88 on which the corporation was entitled to impress a trust.

The corporation was also entitled to follow the trust property and to recover from the transferee not only the value of the property at the date of the trial, but its value in excess of $1,600,000 when it was fraudulently transferred. The value of the property, which was conveyed in fraud, may be recovered from the transferee based on the valuation at the date of the fraudulent transfer (*Klein* v. *Hoffheimer*, 132 U. S. 367). Ola Young, who was sought to be joined as a party under the proposed complaint of the intervenors, was liable for the true value of the property at the date of the conveyance.

V.

Petitioners Were Entitled to Intervene and to Obtain the Affirmative Relief Prayed in the Proposed Complaint, and the Court of Appeals Clearly Erred in Sustaining the Denial Thereof.

Petitioners moved for leave to intervene within three days after the case was redocketed upon the filing of the mandate (Tr. 6). The reason for the motion is stated therein and in support thereof there was filed a verified petition by over 100 stockholders (Tr. 8) and a proposed draft of a complaint (Tr. 11) wherein it was sought to make Ola Young, the Lay Improvement Company and the Detroit Bank additional parties defendants in order

to obtain such relief. The complaint also sought affirmative relief to obtain the return of 40,983 shares into the treasury of the corporation and a refund of salaries, drawn during the pendency of the appeal and for other affirmative relief.

The sufficiency of the petition was *not challenged*. The objections (Tr. 23-30) were: (a) that the court is without jurisdiction of the subject matter of the petition, based on the contention that the mandate remanding this cause for the purpose of proceeding in accordance with the opinion of this court (127 Fed. (2) 721), limited the inquiry to the question of insolvency; (b) that the petition was not timely filed, and (c) that the denial of the intervention on the appeal constitutes an adjudication on the right to intervene below, after the remandment.

We will show that none of the contentions are sound.

(a) The opinion did not limit the jurisdiction of the court to the hearing on the insolvency of Young.

The opinion (127 F. (2) 721) points out that in *addition* to the question of insolvency, *other objections were urged by petitioners.* It says:

> "He *also* contended that the payment of $275,000 cash should be distributed as a dividend to the stockholders, but that Young should be denied any participation therein."

The opinion thereafter stated:

> "In effect the court refused to exercise the discretion imposed upon it of giving full consideration to all the facts available with reference to the adequacy and fairness of the statement upon the ground that it had no power to do so since the attorneys of record approved the compromises. * * * The appel-

lant had a right to invoke the discretion of the court to decide whether the compromise recommended did in fact protect the interest of the corporation and of the stockholders."

The opinion further said:

"The exercise of discretion does not permit the court to disregard the substantive principles of law established for the protection of litigants. One of these principles is that judgments and decrees which make findings of fact shall be founded on evidence. Thus it is an abuse of discretion to refuse to receive and consider evidence by which the court's discretion shall be guided or controlled. * * * The court was bound to hear the legal testimony covering the compromise. Otherwise, it would safely decide the question of its propriety."

After laying down these principles, the Court said:

"It *also* required that, subject to the control of the court properly exercised under the facts of the case, appellant be permitted to go forward with the evidence limited to the single subject of the solvency of Young." (Emphasis ours.)

The word "*also*" is of great significance as the opinion puts *first the burden* upon the court to find and ascertain from proper evidence in the case as to the fairness of the settlement and then it says that Benjamin E.-Cohen may *also* be permitted to go forward with evidence on the issue of insolvency. It is, therefore, *clear from the opinion that there was no limitation on the power or jurisdiction of the court to proceed with anything that may be material on the issue of the fairness* of the settlement or compromise.

(b) **The reversal of the decree with directions for further proceedings not inconsistent with the opinion had the effect of placing the case in the same position as if no decree had ever been entered, and the court had the power to permit intervention, amendments, enlarging the issues, and to admit further proof as it had before the entry of the decree.**

The contention that the mandate of the court was a limitation on the power of the trial court to only hear the insolvency of Young and that the court was powerless to hear anything else, *is without any basis in law.* This contention was decided *adversely* by the Seventh Circuit in *Hawkins* v. *Cleveland,* 99 Fed. 322. We quote the following from this opinion (p. 324):

> "In the present case the decree below was reversed, but, instead of a direction for the entry of any particular decree, the mandate was, as stated, **that further proceedings should be had, not inconsistent with the opinion of this court. The effect was to put the case in the same posture as if no decree had ever been entered, and in that situation the court had the same authority to permit an amendment** of the petition or bill of the appellee for the purpose of enlarging the issue and of **admitting further proofs as it had before the entry of the reversed decree.** In the case of *In Re Sanford Fork & Tool Co.,* 160 U. S. 247, 16 Sup. Ct. 291, 40 L. Ed. 414, affords an apt precedent." (Emphasis ours.)

The same doctrine was announced by the Fourth Circuit in *Liberty National Bank* v. *Baer,* 4 F. (2) 241. Abundant authorities are there cited. At page 242, the court said:

> "Again, *had the Supreme Court intended to shut off amendment and trial* of the issue of insolvency, its appropriate order and mandate would have been for the reversal of the decree of the Circuit Court of

Appeals and affirmance of that of the District Court, as in *Cole* v. *Ralph,* 252 U. S. 286, 308, 40 S. Ct. 321, 64 L. Ed. 567, and many other cases. This the Supreme Court was careful not to do. *On the contrary, it merely reversed the decree of the Circuit Court of Appeals and remanded the case to the District Court for the further proceedings not inconsistent with its opinion.*"

The Court further said:

"In that situation, the rule is well established that when the appellate court remands the case for further proceedings not inconsistent with its opinion or in conformity therewith, *it expresses the intention that its decree should not be final and the pleadings should be open for amendment at the discretion of the trial court.* This is expressly decided in *Re Sanford Fork & Tool Co.,* 160 U. S. 247, 255, 259, 16 S. Ct. 291, 40 L. Ed. 414; *Smith* v. *Adams,* 130 U. S. 167, 177, 9 S. Ct. 566, 32 L. Ed. 895; *Mutual Life Insurance Co.* v. *Hill,* 193 U. S. 551, 553, 24 S. Ct. 538, 48 L. Ed. 788; *In re Louisville,* 231 U. S. 639, 645, 34 S. Ct. 255, 58 L. Ed. 413; *Louisville* v. *Cumberland Telephone Co.,* 231 U. S. 652, 34 S. Ct. 260, 58 L. Ed. 419; *Arkadelphia Co.* v. *St. Louis S. W. Ry. Co.,* 249 U. S. 132, 143, 39 S. Ct. 237, 63 L. Ed. 517; *Wells Fargo & Co.* v. *Taylor,* 254 U. S. 175, 181, 41 S. Ct. 93, 65 L. Ed. 205."

This rule was also followed by the Second Circuit in *Bibbee* v. *Paragan,* 89 F. (2) 18, 19.

The foregoing authorities, therefore, decisively hold against the contention that the trial court was without power or jurisdiction to permit the filing of the petition for intervention or to hear anything else but the question whether or not Young was insolvent. These authorities are squarely in conflict with the opinion of the Sixth Circuit.

The Complaint stated that since the entry of the decree Young has drawn salaries totalling $148,000 for the year 1941 in violation of the injunction which limited his salary to $50,000 per year (R. p. 174). This drawing occurred *subsequent to the filing of the appeal* and during its pendency. The Complaint also sought affirmative relief against other persons, on issues which were not raised on the prior hearing and not determined in the opinion. *Under such circumstances the trial court had the power to hear such matters*, regardless of the question whether or not the reversal with directions to proceed in conformity with the opinion limited the issue only as to the insolvency of Young. This question was squarely decided by the Seventh Circuit in *Illinois Bell Telephone Co.*, 102 F. (2) 58, where the Court held that *matters which were not in issue on the prior appeal and not disposed of by the opinion are not foreclosed by the mandate*. The *right* to file *a supplemental amendment* as to matters which occurred *subsequent* to the trial and *during the pendency* of the appeal, was squarely settled in *Texarkana* v. *Arken & Co.*, 306 U. S. 188, 203.

(c) The application for leave to intervene upon the reversal of the decree was proper and timely.

The question what is "timely" under Rule 24 (a) and (c) must be determined in each case under the particular facts as the rule is silent on what constitutes timely.

In *Sims* v. *Andrews*, 118 F. (2) 803, the court said:

> "The rule is silent as to what constitutes timely application and the question must therefore be answered in each case by the exercise of sound discretion by the trial court."

This "sound discretion" embraces a consideration of the essential facts and the application of settled legal principles.

(1) The application for intervention by a member of a class after he discovered that he was not adequately represented by his alleged representative is deemed timely.

Thus, in *Leary* v. *United States*, 224 U. S. 567, the Supreme Court *reversed the denial of intervention where the application was filed five years after the commencement of the cause of action* and the taking of evidence. The case was pending since 1903 and the intervention was applied in 1908. In reversing the action of the Circuit Court of Appeals which denied the intervention on the ground that it was not timely presented, the Court said at page 576:

> "If the claim is well founded and she knew of this suit, *it was not laches in her to assume that Koellog would do his duty as her trustee.* She might be bound by a decree against him, but *before decree on discovering his conduct she fairly may protect herself* • • • She presents a case which unless read with an *adverse mind* is a good one on its face, and whatever misgivings we may entertain, we are of the opinion that *she ought to be allowed to try to prove it.*" (Emphasis ours.)

This case is directly in point here. Petitioners received a notice for the settlement of the class suit. This notice failed to state the nature of the claims (R. 325). Even if all of the facts were made known to the stockholders *they had a right to rely that their trustee, the plaintiff in the class suit,* would protect their interest. When they discovered *subsequent* to the entry of the decree that their interests were not well represented and that an *unfair settlement was made* and that an appeal was prosecuted, *they immediately moved to protect their interests and applied* here for leave to join in the appeal. Their right to join in the appeal was denied on the

ground that *their time to appeal had expired. Immediately,* upon the filing of the mandate of reversal, they moved for leave to intervene. *This was timely.*

(2) The application to intervene below after the remandment was proper and timely notwithstanding the denial to intervene on the appeal.

As soon as petitioners ascertained the facts they moved for leave to intervene on the previous appeal which was denied. The right to intervene in the trial court after the remandment existed notwithstanding the denial of the intervention on the appeal. This was squarely decided in *Morin* v. *City of Stuart,* 112 F. (2) 585. There, the court held that while intervention was improper on the appeal *it would be timely and proper to intervene thereafter in the event of the reversal.*

In *Piccard* v. *Sperry Corporation,* 36 F. Supp. 1006 (affirmed 120 F. (2) 328) the court rejected a proposed settlement of a class suit which was recommended by the plaintiff. Stockholders who failed to comply with Rule 23 (b) asked leave to intervene on the grounds that the plaintiff who recommend the settlement did not adequately represent the members of the class. This intervention was denied on the ground that the stockholders did not comply and could not comply with rule 23 (b) but in entering the denial order the court stated (p. 1010) that *the denial was without prejudice to stockholders who were able to comply with the rule to thereafter intervene.*

It is apparent, therefore, that subsequent to the determination that the recommendation of the plaintiff to accept this settlement was improper that *other stockholders may come in thereafter to protect their interests* and that their application at that stage of the proceeding is deemed *timely.*

In the *Decker* case, 39 Fed. Supp. 592, intervention was allowed after the remandment of the case and the application was held to be timely.

(3) The right of intervention was absolute and not discretionary.

One of the grounds for the petition for intervention is as set forth in the petition that the petitioners were *inadequately* represented by the representatives of the class. *The sufficiency of the petition was not challenged* and is, therefore, *conceded to be true.* The question that presents itself is whether members of a class who are not adequately represented may intervene as of *right.* This is provided for by new Federal rules. Rule 24 (a) (2) under the heading "Intervention of Right" is decisive on this point (Moore's Federal Practice, pp. 2333, 2345). This rule must be given a *liberal* construction (*U. S.* v. *C. M. Lane,* 25 F. Supp. 410; *Brotherhood et al.* v. *Chicago, et al.,* 34 F. Supp. 594).

The evidence in the case showed that the representative of the class did not adequately represent the class. It is true that the court accused counsel for the Objectors of want of good faith in making the charge that the class representative did not adequately represent the class, and it pointed out that the plaintiff's attorneys were reputable members of the bar (Tr. 92). There was no contention that the attorneys were not able or not reputable. The most reputable attorney may err in his judgment and a party in interest may charge that with all due respect to the reputation of the attorney he is not adequately representing him and seek another attorney to represent his interest and this may all be done in good faith, as it was done in this case.

Plaintiff's attorneys recommended the approval of the settlement on June 29, 1940 because of their conviction that Young was insolvent (R. 582). They based their opinion upon *an audit which was not verified and which now develops to have been untrue.* The auditor who made the audit and who stated therein that he examined the books and based his audit on the books, *was unable to justify his statement that the books showed that there was cash on hand in the amount* of $4,091.21 (Tr. 379). He was asked as a witness to show the entry in any of the books (Tr. 233) and he was unable to show it. He scheduled assets shown on the books in the amount of $572,622.62 to be valued at $5,000.00 (Tr. 380). In the last audit on which the court based its valuation, one of these items, the obligation due from L. A. Young of $239,841.21 which was included in the $5,000 asset was conceded to be worth $108,000 (Tr. 415, note C). Plaintiff's attorneys again recommended the approval of the settlement *notwithstanding the disclosure that the audit upon which they relied was untrue.* After the demonstration of the falsity of the audit and the showing made by the petitioners as to the solvency of Leonard A. Young, plaintiff's attorneys *still recommended the settlement* on the proposition that he was insolvent. To sustain their position *they attempted to show by witnesses who were incompetent to testify as to the valuation of the property.* They offered in evidence an audit based on estimates by an auditor who according to his own testimony had no conception of any of the values contained therein. Under such circumstances the statement that the members of the class were inadequately represented *was a true and correct statement.*

Petitioners were also interested in the fund to be distributed. There was paid in $275,000 which was in the

possession of the court under the prior decree. There was withdrawn by Leonard A. Young during the pendency of the appeal $148,000. This was done in violation of the restraining order which prohibited a withdrawal in excess of $50,000 (R. 174). The question whether the $275,000 should be returned less the $148,000 withdrawn in the event of the rejection of the settlement, *was a question in which the petitioners were directly interested and their right to intervene was absolute.* There was, therefore, a fund within the control of the court and the right to intervene exists under Rule 24 (2) (3). (Moore's Federal Practice, p. 2338. See also *Piccard* v. *Sperry Corporation,* 36 F. Supp. 1006, affirmed 120 F. (2) 328).

(4) Intervention should have been allowed in order to bring in additional parties and to obtain appropriate relief.

The intervenors were also seeking the right to intervene, to bring in additional parties, and to obtain additional relief. Their right to do so in a class action is supported by ample authority. (Moore's Federal Practice, pp. 2391, 2392; *Decker* v. *Independent Share Co.,* 39 Fed. Supp. 592; *Johnson* v. *Reveland,* 117 F. (2) 711).

(5) The denial of intervention on the appeal after the expiration of the time to appeal is not an adjudication on the right to intervene upon the remandment of the case.

The point that the denial of the intervention on the appeal constitutes an adjudication on the right to intervene (Tr. 26) after the remandment was wholly without merit.

The adjudication by the court was on the ground that *the time to appeal had expired* and had no bearing on the issue whether intervention should be allowed in a

trial below. The contrary thereto was held in *Morin* v. *City of Stuart*, 112 F. (2) 585, *supra*.

In *Wells, Fargo & Co.* v. *Taylor*, 254 U. S. 171, the point was made that after the rendition of the decision holding that the complaint did not state a cause of action a petition for a rehearing was presented which asked to direct the trial court to permit an amendment to remedy the defect. The denial of this petition was urged as an adjudication on the right of the trial court to permit the filing of an amendment thereafter. *This Court held* (p. 182) *that the action of the Court of Appeals did not foreclose the right of the trial court to permit the amendment.*

The trial court conceded (Tr. 111) that the **"proposed amended complaint presents a somewhat different theory upon which recovery may be had", and it was not certain "that that limitation would have been placed in the opinion of the Circuit Court of Appeals" if "the proposed amended complaint was presented to that court"**. It follows that it was error to deny the intervention.

VI.

While the Court Had the Power Under Rule 23 to Compromise the Claims It Had No Power to Condone the Frauds.

We know of no law which empowers a court to condone fraud in approving a compromise of a claim. Rule 23 does not confer authority on the court to compromise and sanction frauds. Its intent was to protect absent creditors from the effect of a consent decree to be pleaded as *res adjudicata* or the dismissal which may surrender a cause because of the intervention of the Statute of Limitations. *It was a protection to creditors but not as a*

power to a court to impose the settlement or compromise which includes the compromise of the fraud without protective measure from this repetition when the affairs of the corporation are entrusted to the person who committed the fraud in the past. In adopting Rule 23(c) the Committee was asked to include therein provisions for judgment and the effect thereof, but *this was expressly excluded from that Act.* (Moore's Federal Practice, pp. 2277-2283.)

The same principle of law which forbids a corporation from ratifying an illegal act on the grounds of public policy (13 Am. Jur., Section 98c) should prevent a court from condoning such acts.

The question whether a class action may be compromised when no consent is obtained from all creditors is discussed in a leading article by McLaughlin in 46 Yale Law Journal, page 421. *The author there states that not a single case can be found on the proposition that a court may compromise a claim when no consent is obtained.* He does cite one *nisi prius* decision in New York where a court held a meeting of the stockholders, and after the majority approved the settlement the court entered an order but the question there was not presented by direct appeal. It was presented by an independent suit by one of the stockholders, and the court held that the adjudication was *res adjudicata.*

The question here is not presented by an independent or collateral suit but it is a *direct* appeal. *We challenge the power of the court to enter the order in the face of the request of the petitioners for a trial on the merits.* It is our contention that where a representative of a class maintains a class suit and he is desirous of settling on behalf of the class and a member of the class desires

to prosecute the cause the court may impose terms such as the guaranty that there will be no loss to the persons desiring the settlement or other conditions that the court may impose, but it is without power to deny the objector the right to prosecute the cause at his expense. (11 American Jur., p. 257, par. 10.) Even if it be conceded for the sake of argument that the court has the power to settle and compromise ordinary claims it is certainly *without power to settle and compromise claims against officers and directors for fraud and breach of trust and to condone such frauds and permit such officers to remain in control of the corporation in the future.* Such a settlement or compromise is *contrary to public policy* and even the consent of all the litigants would not confer such power or jurisdiction on the court. (21 C. J., p. 812, par. 964.)

CONCLUSION.

The *per curiam* opinion which adopted the ruling of the trial court and which based its affirmance of the decree on the point that the findings were supported by substantial evidence when the substantial evidence was clearly incompetent, is in conflict with the decisions of other circuits and with the decisions of this court, and the writ should, therefore, be issued.

Respectfully submitted,

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